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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
International Settlement Rates	)	IB Docket No. 96-261

COMMENTS OF TELEFONOS DE MEXICO, S.A. DE C.V.

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Teléfonos de México, S.A. de C.V. ("Telmex") submits these Comments in response to the above-captioned Notice of Proposed Rulemaking ("Notice") proposing to establish reduced benchmark settlement rates for international message telephone service between the United States and other countries. As the local exchange carrier and a competitor in the newly open Mexican telecommunications market, Telmex supports the Commission's stated goals in this proceeding of promoting effective competition in the global market for communications services, preventing anticompetitive conduct in the provision of international services and facilities, and encouraging foreign governments to open their communications markets.[1] To the extent that the Commission continues to adopt policies, such as the policy recently articulated in the Flexibility Order,[2] that encourage U.S. carriers to consider the competitiveness of individual countries' telecommunications markets in carrier-to-carrier

[1] Notice at ¶ 5.

[2] Regulation of International Accounting Rates, Fourth Report and Order, FCC 96-459, Docket No. CC 90-337 Phase II (released Dec. 3, 1996) ("Flexibility Order").

settlement rate negotiations, the Commission will help achieve these goals and thereby lead to the negotiation of lower settlement rates.

For the reasons set forth below, Telmex urges the Commission to continue to pursue such a market-oriented settlement rate policy for U.S. carriers, particularly where, as in Mexico's case, both the foreign government and foreign carriers have demonstrated a firm commitment to move towards competitive telecommunications markets and a willingness to reduce settlement rates with U.S. carriers in conjunction with the transition to a competitive environment. In contrast, Telmex strongly opposes the Commission's proposal to unilaterally establish a rigid benchmark rule that cannot achieve the same procompetitive results. Rather than enforcing a strict, misguided "one-size-fits-all" benchmark, the most efficient way to achieve the Commission's procompetitive goals is to allow foreign carriers such as Telmex to enter the U.S. market and to rely on market forces to lead carriers to lower settlement rates.

INTRODUCTION AND SUMMARY

Telmex, the former Mexican national telephone company, holds a concession to provide local and long distance service throughout Mexico.[3] Since Telmex's 1990 privatization, the Mexican Government has pursued an aggressive procompetitive policy, introducing competition in the provision of facilities and resale-based switched long distance services by new market entrants in August 1996, and requiring the interconnection of competitors' networks with Telmex's network beginning on January 1, 1997. Several operators affiliated with U.S. carriers, including Alestra (a consortium including AT&T Corp.) and Avantel (a consortium including

[3] See Amendment to the Concession of Teléfonos de México, S.A. de C.V., Official Gazette, Dec. 10, 1990. Telmex's concession does not include an area separately licensed to Teléfonos del Noroeste, S.A. de C.V., a wholly owned subsidiary of Telmex.

MCI Communications Corp.), have obtained concessions from Mexico's Secretaría de Comunicaciones y Transportes ("SCT") or the newly formed independent Comisión Federal de Telecomunicaciones ("Cofetel") to provide long distance service and are actively competing in Mexico today.[4] In fact, the Chief of the International Bureau recently observed that "Mexico is taking a real leadership role in introducing competition in telecommunications."[5]

As a necessary corollary to this transition to competition, both the Government of Mexico and Telmex have understood that settlement rates between U.S. and Mexican carriers should decrease.[6] Over the past decade, Telmex reduced the average settlement rate per minute that its U.S. correspondents pay it by almost 60%, from 98 cents to 39.5 cents, and Telmex has increased the per minute rate that it pays U.S. carriers to terminate northbound calls by almost 36%, from 29.1 cents to 39.5 cents. As of January 1, 1997, the average settlement rate that U.S. and Mexican carriers pay each other is 39.5 cents per minute. Despite these large settlement rate reductions, and due (among other reasons) to the close economic relationship that a common border between the U.S. and Mexico brings, Telmex received $875.7 million in net settlement payments from U.S. carriers in 1995.[7]

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4 See "AT&T Venture Gets Fast Start in Mexican Race: Despite Problems, Alestra Scores With Marketing in Long-Distance Wars," Wall Street Journal, Jan. 21, 1997; "Mexican Rivals Campaign for Callers," New York Times, Jan. 14, 1997; "Mexican Firms Claim Victory in Phone Wars," Wall Street Journal, Jan. 6, 1997; "A Telecom Revolución in Mexico," New York Times, Nov. 14, 1996.

5 "Mexico's Telecommunications Giant Reaches Out, and North," New York Times, Jan. 4, 1997; see also "Taking a Gamble, MCI Plunged Into Mexico as AT&T Hesitated," Wall Street Journal, Nov. 18, 1997 (noting that "Mexico is staging what may be the world's next great telecommunications free-for-all").

6 See Notice at ¶ 16 (noting that Mexico has "explored accounting rate reform").

7 Id. at Appendix B.

As competition takes further hold in Mexico, basic economics will dictate that Mexican carriers' settlement rates with U.S. and other carriers will continue to decrease. The Commission's Flexibility Order properly gives guidance to U.S. carriers to negotiate those reductions by relying on market forces to the greatest extent possible, and encouraging carriers to take the unique facts and circumstances of individual countries and carriers into account in their negotiations. In contrast, the Commission is far wide of the mark in proposing to ignore those market forces and to set rigid benchmark accounting rates based on unilateral U.S. estimates of foreign carriers' incremental costs. Such an approach could undermine, rather than promote, competitive forces, as the attached Statement of INDETEC International ("INDETEC Statement") describes in more detail.

Rather than adopt a strict, unwarranted benchmark rule, the Commission should encourage settlement rate reductions by promoting increased, unfettered, and symmetric competition in the U.S. and abroad. As the Commission is aware, Telmex expects to file an application shortly for authorization under Section 214 of the Communications Act to provide international long distance services in the U.S., just as U.S. carriers currently are doing in Mexico. Consistent with the clear implications of the Flexibility Order, the solution to the Commission's concerns over how best to promote global competition and encourage movement towards cost-based accounting rates is to allow foreign carriers such as Telmex to compete in the U.S. and thus to grant Telmex's forthcoming application promptly.

I. APPLYING A FLEXIBLE POLICY TO U.S. CARRIERS' SETTLEMENT RATE NEGOTIATIONS WILL ENHANCE U.S. AND GLOBAL COMPETITION AND THEREBY LEAD TO SETTLEMENT RATE REDUCTIONS.

In its recent Flexibility Order, the Commission reasoned that "a more flexible framework that allows for relaxing regulatory rules and removing entry barriers will best support the development of competitive market structures and deliver the benefits of such structures to consumers."[8] The Commission therefore endorsed, subject to certain competitive safeguards, the negotiation of alternative payment arrangements between U.S. carriers and foreign carriers from countries that satisfy the effective competitive opportunities ("ECO") test set forth in the Foreign Market Entry Order.[9] In recognition of the distinctions among foreign countries' and carriers' individual situations, the Commission stated that such arrangements also may be appropriate for countries that do not satisfy the ECO test, provided that the U.S. carrier can show that such flexibility "will promote market-oriented pricing and competition, while precluding abuse of market power by the foreign correspondent."[10] Applying such a market-oriented policy to U.S. carriers on a broad basis will enhance competition and in turn lead to decreased settlement rates.

A flexible policy that encourages U.S. carriers to base bilateral settlement rate negotiations on the market forces emerging in each country is essential because market conditions, and the factors that carriers therefore must consider in their negotiations, differ dramatically from country to country. The Commission has noted the "diversity and asymmetry" of the countries moving towards competitive markets and the fact that "[m]ovement toward

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8 Flexibility Order at ¶ 26.

9 See Market Entry and Regulation of Foreign-Affiliated Entities, 11 FCC Rcd 3873 (1995) ("Foreign Carrier Entry Order").

10 Flexibility Order at ¶¶ 2, 40.

competition is being handled in different countries on different timetables and in different ways."[11] For example, in light of their national needs and a host of factors unique to each country, foreign regulators may have imposed costly universal service requirements on foreign carriers or mandated the provision of unprofitable services. Carriers competing for the first time also may be forced to invest heavily in new technology. In short, every carrier's market and cost structure are different.[12]

The Commission consistently has emphasized the importance of ensuring that its accounting rate policy, and thus U.S. carriers' settlement rate negotiations, take into account the unique facts and circumstances of each country. As the Commission explained in its recent Accounting Rate Policy Statement:

> Competitive markets and technological advances do not develop simultaneously in all countries. Some governments have not embraced private ownership and competition. Additionally, economic conditions vary among countries; for example, cost characteristics, facilities, and resource endowments differ. We believe our approach to accounting rates should be flexible enough to recognize different market conditions throughout the world.[13]

Continuing to apply to U.S. carriers a more flexible policy therefore is fully consistent with the Commission's own recognition of the need to ensure that its accounting rate policy does not undermine different developing competitive conditions around the world.

As a matter of basic economics, supporting countries' differing paths to competition in turn will lead carriers to negotiate lower settlement rates. Competition will

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11 Foreign Carrier Entry Order, 11 FCC Rcd at 3879.

12 See INDETEC Statement at 8-10.

13 Policy Statement on International Accounting Rate Reform, 11 FCC Rcd 3146, 3149 (1996) (emphasis added).

provide commercial incentives for foreign carriers to reduce their costs and to recognize the business and technological necessity of modifying the terms and conditions of their settlement rate agreements.[14] Indeed, the Commission itself recognized only 15 months ago in the Foreign Carrier Entry Order that the growth of competition stimulates demand for foreign carriers' services, reducing their need to rely on settlement revenues and encouraging them to move their accounting rates towards cost-based levels. As the Commission explained:

> We also disagree with AT&T's argument that competition may not ensure significant progress towards cost-based accounting rates. We believe that additional service providers will increase supply options, and lower foreign calling prices. These actions should stimulate demand, and increased usage of fixed plant should reduce the carriers' average unit costs. In addition, greater demand may increase net revenues thereby reducing foreign carriers' need to rely on settlement payments to finance investment and enabling reductions in the level of accounting rates. Thus, increased global competition will encourage foreign carriers to move accounting rates towards cost-based levels.[15]

Nothing has changed since the Commission reached that conclusion. If anything, the Commission's theory -- that increased competition leads to settlement rate reductions, not the other way around as the Commission now appears to believe -- is proving correct. There can be no dispute that the decade of the 1990s is bringing about important changes in formerly closed telecommunications markets, resulting in liberalized market structures and emerging competition among facilities-based carriers, resellers, and arbitrageurs. As a result of these significant changes, as the Commission observes in the Notice, settlement rates between U.S. and foreign carriers have been decreasing by large amounts, from an average settlement rate per minute of

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14 See INDETEC Statement at 1, 4-6.

15 Foreign Carrier Entry Order, 11 FCC Rcd at 3899.

51.5 cents in 1992 to 36.5 cents in 1996, or almost 30%.[16] Settlement rates between U.S. and Mexican carriers in the 1990s show an even greater decrease.

In its Notice, the Commission acknowledges the importance of having a settlement rate policy that is flexible enough to recognize competitive developments in foreign markets.[17] But the Commission's proposals to forbear from imposing its proposed benchmark rates[18] or to allow a longer transition to those rates for carriers from developing countries, such as Mexico, that are committed to competitive reform[19] plainly are insufficient. As a practical matter, U.S. carriers will use the Commission's benchmark rates as "stakes in the ground" in negotiations with foreign carriers and effectively attempt to impose those rates on their foreign correspondents -- regardless of the foreign carriers' circumstances or the factors that determine when and how their countries decide that the time is right to introduce competition.[20] In contrast,

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16 See Notice at ¶ 26; see also "Trends in the International Telecommunications Industry," A Report Prepared by the Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, Aug. 1996, at 55 (noting that "[c]urrency rate fluctuations, accounting rate reductions, changing traffic patterns, and the growth in services such as USA Direct have all influenced the average settlement payment per minute"); id. at 62 (graphically illustrating the decline in accounting rates between 1986 and 1995).

17 See Notice at ¶¶ 69-74.

18 See id. at ¶ 69.

19 See id. at ¶ 70.

20 As Telmex's own history of negotiating with its U.S. correspondents has shown, the major U.S. carriers are formidable negotiators. Even prior to the introduction of competition in Mexico, Telmex hardly was in a position to "whipsaw" any of the U.S. carriers or unilaterally dictate the result of the parties' negotiations, and Telmex in fact did not do so. The Commission has confirmed this experience, noting its own doubts as to foreign carriers' negotiating leverage with U.S. carriers:

> We are not convinced that dominant foreign carriers can set the "input" accounting rate level unilaterally. These rates are established by negotiation between a U.S. and foreign carrier. Competitive pressures from end users and carriers, as well as our International Settlements

(continued...)

a policy that is based directly on the emerging market forces in each country will encourage greater competition and in turn lead to lower settlement rates.

II. A FLEXIBLE POLICY IS PARTICULARLY APPROPRIATE FOR U.S. CARRIERS' SETTLEMENT RATE NEGOTIATIONS WITH CARRIERS FROM COUNTRIES SUCH AS MEXICO.

The case of Mexico illustrates why the Commission should continue to pursue a flexible, market-oriented policy governing U.S. carriers' settlement rate negotiations with foreign carriers. In Mexico, the Government has carefully and successfully implemented a policy that over a multi-year period is completely transforming the country's telecommunications market. Over the past ten years, Mexico has made great strides in developing its telecommunications infrastructure, enabling the completion of calls and the transmission of data to virtually every region of the country. Most importantly, Mexico opened its telecommunications market to competition in August 1996, and Telmex successfully implemented interconnection with the new competitors beginning on January 1, 1997. Ensuring that carriers in bilateral negotiations are permitted to account for such sweeping changes will encourage the further opening of the Mexican market, to the benefit of Mexican and U.S. consumers.

Mexico is accomplishing the introduction of competition via equal access at a rate that far surpasses the rate at which such competition has been introduced anywhere in the world, including in the U.S. Presubscription and dialing parity are being activated on a city-by-city

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(...continued)

> Policy, have strengthened the position of U.S. carriers during accounting rate negotiations, and we expect this trend will continue.

Foreign Carrier Entry Order, 11 FCC Rcd at 3899; see also Motion of AT&T Corp. To Be Declared Non-Dominant for International Service, FCC 96-209 (released May 14, 1996) (noting AT&T's ability to negotiate favorable settlement rate arrangements with foreign carriers).

basis, beginning with Querétaro's 81,000 access lines and Monterrey's nearly 523,000 access lines in January 1997. Interconnection will take place between April 1 and May 19, 1997 for Mexico City's 2.8 million access lines. Over 75% of the access lines in Mexico, covering 60 cities, will have completed presubscription by July 1, 1997.

Numerous new long distance providers now compete, or shortly will begin competing, with Telmex to provide national and international long distance service in Mexico, and additional applications for concessions are pending before the Mexican regulator.[21] Seven of the nine competitors are affiliated with U.S. partners, as the following table shows.[22]

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21 One of the nine competitors, Extensa, only received its concession in January 1997. Two other competitors, Bestel and Telinor, are not planning to commence operations until the end of 1997.

22 In addition to the seven U.S.-affiliated carriers identified in the table, one carrier, Miditel, has substantial Korean investment. Only Bestel is wholly Mexican owned. Telmex notes that SBC International holds 9.57% of Telmex's shares, that France Telecom holds approximately 5%, and that Telmex's stock is publicly traded on the New York Stock Exchange.

Mexican law permits up to 49% foreign ownership of the controlling shares of facilities-based telecommunications providers. There are no foreign ownership restrictions, however, for resale or cellular service. Furthermore, Cofetel may allow foreign control of facilities-based providers under certain circumstances, and a request to allow such control by Bell Atlantic over Iusacell, the parent company of Iusatel, presently is pending.

MEXICAN COMPETITORS WITH U.S. OWNERSHIP	
CARRIER	**U.S. PARTNER(S)**
Alestra	AT&T, GTE
Avantel	MCI
Extensa	Communications Equity Associates
Investcom	Nextel, LCC, Carlyle Group
Iusatel	Bell Atlantic
Marcatel	IXC Communications, Westel
Telinor	AirTouch

Alestra and Avantel in particular already are competing vigorously in Mexico. Alestra reportedly spent $500 million in 1996 to build 2666 miles of fiber optic lines, install computer equipment, and update its corporate headquarters, and claimed to have processed 3459 national long distance calls and 222 international long distance calls in the first few days of January.[23] Avantel reportedly was the first competitor to construct its network, including a major switching facility and voice center in Apodaca, Nuevo León, and on August 11, 1996, activated 3,300 miles of its long distance network following a nearly $1 billion investment.[24] Avantel claimed to have processed 13,000 long distance calls in less than the first week of competition in Querétaro in January.[25]

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23 See "Mexican Firms Claim Victory in Phone Wars," Wall Street Journal, Jan. 6, 1997.

24 See "Taking a Gamble, MCI Plunged Into Mexico as AT&T Hesitated," Wall Street Journal, Nov. 18, 1997; see also Avantel Website (www.avantel.com.mx), "Acerca de Avantel: Vista General de la Empresa."

25 See "Mexican Firms Claim Victory in Phone Wars," Wall Street Journal, Jan. 6, 1997.

To govern this transition to competition, the Mexican Government has adopted a series of regulations to ensure that the introduction of competition meets the country's needs. On December 4, 1996, Cofetel issued its International Long Distance Rules, which govern international settlement and gateway issues. The regulations acknowledge that the existing accounting rate structure ultimately must be replaced by market-driven forces, but reflect the Mexican Government's view that, in the meantime, a precipitous drop in settlement rates could undermine the procompetitive results achieved to date. Among other things, the new regulations therefore keep in place the existing proportionate return requirement for three more years, but leave Cofetel the option of reexamining the need for proportionate return and other accounting rate policies at any time.[26]

Telmex likewise has understood the need to reduce accounting rates in order to position itself to compete effectively. In fact, over the last decade, settlement rates between U.S. and Mexican carriers have decreased substantially. As shown in the following table, which is based on Telmex's data, the average settlement rate per minute that U.S. carriers pay Telmex (and now other Mexican carriers) has declined, and the rate that Telmex (and now other Mexican carriers) pay U.S. carriers has increased, resulting in an even lower effective settlement rate for Mexican carriers, until that rate reached "parity" on January 1, 1997.

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26 See International Long Distance Rules, art. 40 (Dec. 4, 1996).

U.S.-MEXICO AVERAGE SETTLEMENT RATES PER MINUTE		
YEAR	**SOUTHBOUND**	**NORTHBOUND**
1988	$0.980	$0.291
1989	$0.960	$0.317
1990	$0.779	$0.295
1991	$0.715	$0.280
1992	$0.653	$0.257
1993	$0.615	$0.260
1994	$0.591	$0.256
1995	$0.557	$0.294
1996	$0.504	$0.336
1997	$0.395	$0.395

The effect of these reductions on Telmex is even greater than the settlement rates alone reflect, however, because at the same time that Telmex agreed to reduce settlement rates, it also undertook a major tariff rebalancing in preparation for the introduction of competition. As a result, Telmex now charges considerably less for calls to the U.S. than U.S. carriers charge for an equivalent call to Mexico.[27] In fact, over the past year alone, Telmex has reduced its average per minute rate to the public for a call to the U.S. from $0.9211 to $0.8625, even as U.S. carriers -- despite arguing that settlement rates had to be reduced because U.S. subscribers' rates for calls to Mexico were too high -- failed to flow the substantial settlement rate reductions they received

[27] "Mexico's Telecommunications Giant Reaches Out, and North," New York Times, Jan. 9, 1997.

from Telmex through to their subscribers. According to Telmex's estimates, AT&T's per minute subscriber rates actually have increased from $0.9661 in 1990 to $1.1316 in 1995-1997.[28] Clearly, if the Commission's policy goals as expressed in the Notice are to be achieved, it would only make sense for the Commission to ensure that U.S. carriers reflect settlement rate reductions in subscriber rates.[29]

Despite the reduction in settlement payments and Telmex's subscriber rates, U.S. carriers' net settlement payments to Telmex (and now to other Mexican carriers) have increased. As the Commission notes, Telmex received $875.7 million in net settlement payments from U.S. carriers in 1995.[30] Telmex estimates that it will have received a slightly lower net payment ($837.8 million) for 1996 traffic, and it projects a further decrease in net settlement revenue from U.S. carriers in 1997. While settlement payments to Mexico are now trending down for the first time, Mexican carriers' net settlement revenues from U.S. carriers are likely to remain substantial for the foreseeable future.

But focusing on net settlement revenues alone is incorrect and misleading. Over the ten-year period 1987-1996, minutes of traffic between the U.S. and Mexico have increased substantially. According to Telmex's data,[31] southbound minutes of traffic increased more than

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28 See INDETEC Statement at 10-11 and Table 1; see also "Trends in the International Telecommunications Industry," A Report Prepared by the Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, Aug. 1996, at 35 (noting the increase in AT&T's rates charged on calls to Mexico in 1993).

29 See Notice at ¶ 91.

30 See id. at Appendix B.

31 According to Telmex's data, in 1987 there were 371,059,351 minutes of southbound traffic and 154,533,977 minutes of northbound traffic. In 1996, Telmex's data reflects that there were 2,239,652,952 minutes of southbound traffic and 869,365,357 minutes of northbound traffic. See INDETEC Statement at Table 2.

sixfold over the course of the decade, and northbound minutes of traffic more than quintupled. Moreover, as traffic increased, the ratio of southbound to northbound traffic also increased, from a ratio of approximately 2.4:1 in 1987 to a ratio of more than 2.6:1 in 1996.

The growing traffic flow between the U.S. and Mexico makes clear that settlement rates have had little to do with the net settlement payments that U.S. carriers have made to Telmex. Rather, the large traffic flows are due to a confluence of factors, including the relative levels of economic development in the U.S. and Mexico, the low telephone density of approximately 10 telephone lines per hundred people in Mexico, the growing practice of refiling international traffic through the U.S.,[32] and the large number of U.S. citizens and residents of Mexican ancestry. Moreover, the close economic ties that result from sharing a common border have increased the benefits to U.S. consumers of southbound calling. Assembly plants and other U.S. assets and personnel are located in Mexico because of the economic benefit derived from the location, the labor rate, the relatively lower cost of raw materials, and the geographic proximity of Mexico to other target markets in Latin America.

In fact, the U.S.-Mexico net settlement payment deficit is a small, but misleading, piece of U.S.-Mexico trade relations as a whole, as the INDETEC Statement explains.[33] For the period 1991-1994, Mexico faced a total trade deficit with the U.S. of over $21 billion. For the years 1994 and 1995, the total value of goods traded between the two countries was nearly

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[32] Telmex estimates that approximately 5% of the net settlement revenues that it has received from U.S. carriers is due to traffic refiled through the U.S. Thus, those revenues should be deducted from Telmex's net settlement revenues in order to have an accurate figure for U.S.-Mexico traffic.

[33] See INDETEC Statement at 12.

$230 billion, and the flow of direct investment to Mexico from the U.S. totaled nearly $9 billion. Of these amounts, telecommunications traffic represented a small portion of the total trade between the two countries. Mexico faces a trade deficit with the U.S. in a number of areas in which prices may not accurately reflect cost (much less incremental cost), including pharmaceuticals and medical technologies, computer equipment, banking and credit services, and telecommunications equipment.

Plainly, the transition of Mexico and Telmex to a competitive telecommunications market and the close economic relationship between the U.S. and Mexico are unique. No other country faces the set of facts and circumstances that the Mexican Government is facing in leading the country to a fully competitive market, and no other carrier is undergoing the dramatic changes that Telmex is undergoing as that transition unfolds. Those unique circumstances necessarily bear directly on the extent and timing of future settlement rate reductions between U.S. and Mexican carriers. Applying a flexible settlement rate policy to U.S. carriers' negotiations with a carrier from a country, such as Mexico, that is introducing a competitive telecommunications market structure and that has shown a commitment to reducing settlement rates can only support the country's procompetitive efforts and ultimately benefit U.S. consumers. In contrast, ignoring those emerging market forces only will undermine the development of further competition.

It is essential that U.S. and Mexican carriers continue to have an open dialogue about issues such as the transition to competition in Mexico, particularly now that U.S. carriers are competing in Mexico and Telmex intends to enter the U.S. market. Similarly, the Commission and both the SCT and Cofetel have benefited in the past from a close working relationship and shown mutual respect for each other's regulatory decisionmaking. This close working relationship also has benefited carriers in settlement rate negotiations. For example, in negotiations between Telmex and its U.S. correspondents two years ago, the Commission was instrumental in working with the SCT to guide the carriers towards a range of accounting rates -- rates to which the parties ultimately agreed -- that took into account the competing interests of the U.S. carriers in reducing their net settlement payments and gaining access to the Mexican telecommunications market, as well as Telmex's interest in transitioning over a reasonable period of time to a competitive environment in which it would no longer rely on settlement payments as a source of revenue. That experience demonstrates that, rather than setting a unilateral policy, combining a market-oriented policy similar to that set forth in the Flexibility Order with guidance, as needed, from regulators will encourage the further opening of foreign markets and thus lead to settlement rate reductions.

III. THE BENCHMARK PROPOSAL WILL NOT SERVE THE COMMISSION'S PROCOMPETITIVE GOALS.

In contrast to the policy set forth in the Flexibility Order, the Commission's benchmark proposal falls far short of the mark. By unilaterally setting a predetermined rate that U.S. carriers must use in their negotiations, the Commission's proposal will have an unavoidable extraterritorial reach that could interfere with other national objectives and create additional problems as foreign administrations refuse to enforce the Commission's benchmarks, if not retaliate against U.S. carriers seeking to compete abroad. Moreover, by substituting the Commission's judgment for those of individual carriers facing differing cost structures, the proposed benchmarks may not be relevant to individual carriers' circumstances and therefore may undermine, rather than promote, further movement towards competitive markets.

A. The Proposal's Extraterritorial Reach Could Infringe on Other National Policies and Invite Retaliation Against U.S. Competitors Abroad.

Although the Commission notes that under the Communications Act it has a "statutory mandate to ensure reasonable telephone rates,"[34] the benchmark proposal far exceeds that jurisdictional mandate. Not only can international settlement payments affect U.S. consumers' prices, as the Commission notes,[35] but a preset settlement rate likewise will affect foreign consumers' prices. Indeed, the Commission devotes the bulk of its Notice to its view of the proper pricing structure for foreign markets and its conclusion that foreign carriers should impose interconnection charges based on the "total service long run incremental cost of terminating international service plus a reasonable contribution to common costs."[36]

By imposing controversial U.S. pricing policies on other governments and non-U.S. carriers -- under penalty of breaking or unilaterally modifying negotiated agreements with foreign governments or carriers,[37] or barring foreign-affiliated carriers from access to the U.S. market -- the Commission's proposal does far more than simply seek to reduce U.S. consumers' long distance rates in satisfaction of the Commission's mandate under the Communications Act. The Commission's proposal effectively would supersede bilateral negotiations between U.S. and foreign carriers, override foreign administration's regulatory policies, and affect foreign carriers'

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34 Notice at ¶ 19; see also id. at ¶ 3 & n.3.

35 See, e.g., id. at ¶ 19.

36 See id. at ¶ 31.

37 To the extent that the benchmark proposal would abrogate existing settlement rate agreements, it may raise constitutional issues. Although the Constitution's express prohibition against the impairment of contract, U.S. Const. art. I, § 10, cl. 1, applies to the states and not the federal government, the Due Process Clause of the Fifth Amendment nonetheless protects parties to private contracts against such federal overreaching. See, e.g., National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co., 470 U.S. 451, 472 (1985).

pricing structures. As such, the proposal would set rules implicating economic and trade policies, U.S. treaty obligations, and other international concerns that go well beyond the Commission's statutory mandate.

Because it implicates economic and trade concerns, the Commission's proposal may also conflict with other U.S. Government policies. On numerous occasions the Clinton Administration has called for fair tariff and trade practices with other countries.[38] In fact, in the current World Trade Organization talks, which are scheduled to conclude next week -- the U.S. and other countries have made offers for open market access in basic telecommunications that implicate accounting rate policies. Particularly while those discussions are pending, and in light of the potentially significant regulatory policy changes that could be required in their aftermath, the Commission should not propose rules that could affect the course of those discussions and undermine -- if not violate -- U.S. treaty obligations that soon may be established.

Moreover, because there is no basis in the Communications Act or other U.S. laws, in international law, or in other countries' laws for the Commission to impose a settlement rate on a foreign government or carrier, to directly or indirectly set the prices that a foreign carrier charges for interconnection, or to directly or indirectly set consumer prices in other countries, the benchmark proposal is likely to face serious enforcement difficulties that could undermine its effectiveness in achieving the Commission's goals. Even worse, to the extent that

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38 See, e.g. Remarks by the President to Parliament, Parliament House, Canberra, Australia (Nov. 20, 1996) (noting, among other things, that the U.S. and Australia should work together to "extend the reach of free and fair trade"); Remarks on Goals of the Summit of the Americas in Miami, Florida, 30 Weekly Comp. Pres. Doc. 2485 (Dec. 9, 1994) (noting the goal of creating "a free trade area throughout our hemisphere"); see also "Mexico's Telecommunications Giant Reaches Out, and North," New York Times, Jan. 9, 1997 (noting that "the Clinton Administration has sought strong trade ties with Mexico").

foreign administrations view the proposal as an attempt to impose a U.S. policy extraterritorially -- and indications are that at least some countries do -- they could respond by imposing burdensome obligations on U.S. carriers seeking to compete there or, as the Commission itself proposes here, by barring U.S. carriers from the country's market altogether. This result is exactly the opposite of what the Commission intends to achieve in this proceeding, and exactly the opposite of what a more flexible policy could achieve.

B. Rigid Benchmarks Cannot Account Adequately for Foreign Carriers' Actual Costs.

The rigidity of the Commission's proposal further exacerbates the extraterritoriality problem because the proposed benchmarks appear to be based on incomplete and inaccurate information. Settlement rates always have been negotiated between carriers based on foreign countries' and carriers' individual circumstances and, to the extent possible, emerging market forces. There is good reason for leaving settlement rate determinations to bilateral negotiations instead of setting bright-line benchmark rules. As the INDETEC Statement explains,[39] only the carriers themselves have the resources necessary to make a realistic estimate of the costs that they can expect to incur on a particular route. If anything, the need to defer to individual carriers' own determinations of their costs is magnified in developing countries facing significant market structure changes.

The Commission's benchmark proposal is flawed from the outset because it ignores the fundamental fact that foreign carriers' costs of terminating international calls vary

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39 See INDETEC Statement at 3, 8-10.

substantially from country to country.[40] Depending on the timing and manner in which a foreign regulator has decided to introduce competition, a carrier's costs may be the result of a delicate balance of a variety of factors, including the nation's activities in opening its telecommunications sector to competition, the country's socio-economic status, the financial performance of the country's telecommunications market, and settlement and collection rates. As noted above, in some countries, a foreign carrier's costs may include additional expenses to satisfy government-mandated service obligations such as universal service and infrastructure development. The determination also is complicated in many countries by the variability of international traffic routing and the use of older equipment. As a result, foreign carriers are likely to face a vastly different mix of technologies, engineering criteria, labor contracts, and government requirements than U.S. carriers, and thus they have different cost structures.

Because of these differences, a "one-size-fits-all" Commission-set benchmark -- such as the 19.1 cent benchmark that the Commission proposes to apply to Mexico and the 100 other countries that it designates as lower and upper middle income countries -- is clearly inappropriate. Such a benchmark simply cannot account for a carrier's actual costs or the unique characteristics of each country's communications market. In the case of Mexico, even leaving aside the close relationship between the U.S. and Mexico discussed above, characteristics of Mexico's telecommunications market distinguish it from the markets of every other country in the upper middle income category, as the INDETEC Statement shows.[41]

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40 See id. at 8-10.

41 See id. at 13-15.

For example, of the carriers in the upper middle income category, Mexico's per capita income of $3,969 falls below the category's average of $4,515, and even below the world's average of $4,390. The majority of the countries in the category also have higher population and telephone density. Yet despite these disadvantages, Mexico ranks very high on measures of efficiency compared to others in the same category, with shorter waiting lists for telephone lines, a greater percentage of digital lines, fewer lines per employee, greater revenue per employee, greater investment per line, and higher call completion rates. To the extent that settlement rates contribute to inefficiencies in foreign countries, that does not appear to be the case for Mexico. In other words, Telmex negotiates with U.S. carriers based on a wide range of factors that have nothing to do with its categorization as an upper middle income country.

The International Bureau's calculation of the "international transmission facilities" tariffed component price illustrates the impossibility of an outsider's accurately setting a settlement rate based on the Bureau's benchmark methodology.[42] At $0.009, Mexico's tariffed component price for international transmission is the lowest of all of the countries that the Bureau studied.[43] The next nearest value is that of the United Kingdom, at $0.024, or 267% higher than Mexico's rate; the Netherlands is next at $0.026.[44] In contrast, Brazil, a country that has income and development characteristics similar to those of Mexico, has an international transmission tariffed component price of $0.066 -- a price that is 733% higher than the value determined for Mexico.

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42 See id. at 6-8.

43 See "Foreign Tariffed Component Prices," A Report Prepared by the International Bureau, Telecommunications Division, Federal Communications Commission, Dec. 1996, at 17.

44 See id.

These figures make no sense, at least with respect to Mexico. First of all, the Bureau chose a time period for analysis -- the fourth quarter of 1995 through the middle of 1996[45] -- that does not provide information representative of carriers' current costs in Mexico. During this period, Mexico faced much more rapid rates of inflation (nearly 50% on an annual basis) and a significant devaluation of the peso that drove the value of telecommunications services in Mexico to record low levels. Moreover, the Bureau's reliance on Telmex's private line rates for 1.544 Mbps dedicated circuits is misplaced because, during the period under review, Telmex had few such circuits, used older technology, and offered the lines at very low prices to few customers. In short, the price that the Bureau relied on to make its calculations bears absolutely no relation to the price for such a dedicated circuit today and therefore is simply irrelevant to determining Mexican carriers' costs of terminating U.S.-Mexico traffic.

Further analysis of additional calculations for Mexico and other countries is likely to show a great many such errors, if only because the Bureau could not possibly have had all of the relevant information before it. In fact, the Commission admits in the Notice that the Bureau did not have sufficient data to determine the correlation between its proposed benchmarks and foreign carriers' actual costs and that the relevant data does not even exist for many countries.[46] Even worse, once the Bureau averages together all of the miscalculated figures to obtain a final figure supposedly representative of the costs of all of the carriers in the same category, the calculation is so far removed from individual carriers' actual costs that the result only can underscore the error of following such a methodology in the first place.

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45 See Notice at ¶ 37.

46 See id. at ¶ 33.